



STATE OF DELAWARE
OFFICE OF AUDITOR OF ACCOUNTS

R. THOMAS WAGNER, JR., CGFM, CFE
AUDITOR OF ACCOUNTS

PHONE: (302) 739-4241
FAX: (302) 739-2723

August 25, 2006

To the School Board Members
Positive Outcomes Charter School
Camden, Delaware

In planning and performing our audit of the financial statements of Positive Outcomes Charter School (the School) for the year ended June 30, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal control and operating efficiency. This letter does not affect our report dated August 25, 2006, on the financial statements of the School.

The matters noted are only those that came to our attention, and had our procedures for internal control related matters been more extensive, other matters might have been noted. Also, the functioning of the internal control was assessed at a point in time, and no assurances can be drawn that the internal control is functioning or will continue to function beyond the point in time at which it was assessed. No opinion is being expressed regarding the internal control taken as a whole.

We will review the status of these findings during our next audit engagement.

The attached comments and recommendations in Appendix A and Appendix B are intended solely for the information and use of the School's Board of Directors and management, Department of Education, Office of the Governor, Office of Controller General, Office of Attorney General, Office of Management and Budget, and Department of Finance and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(c), this report is public record and its distribution is not limited.

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts
Office of Auditor of Accounts

OTHER COMMENTS AND RECOMMENDATIONS

Finding #1 – Accounts Receivable

Upon the official retirement of an employee of Positive Outcomes Charter School, the Delaware Department of Education (DOE) was to reimburse the School for the State's share of annual and sick leave. The amount calculated by the School, based on instructions provided by DOE, totaled \$18,259. DOE made payment, in the amount of \$15,083, to the School on June 28, 2006. The School did not research the discrepancy in payment of \$3,176, resulting in underpayment of that amount. Upon inquiry by the auditors, DOE determined that an underpayment had indeed occurred, and subsequently submitted payment to the School.

Good business practices and sound internal controls require the timely research and resolution of discrepancies in amounts due to the School.

Reliance upon information submitted by DOE, without verification, increases the possibility that errors in revenues received by the State will not be detected.

Recommendation

Positive Outcomes Charter School recalculate amounts received from the State, to determine the propriety of revenues. The School contact the appropriate agency(ies) to resolve discrepancies.

Auditee Response

Positive Outcomes Charter School will develop a procedure which requires that all amounts received will be reconciled within 30 days of the receipt of final paper documentation of the amounts. This procedure will be developed and implemented by November 1, 2006.

Finding #2 – Leave Policy

Positive Outcomes Charter School has a policy entitled *Sick Leave and Absences and Other Reasons, Accumulation of Annual Leave*. The sick leave section of the policy states, "Upon the termination (does not include retirement) of a school employee (full-time or part-time), unused sick leave will not be paid out." The annual leave section of the policy does not state if an employee will be paid for unused annual leave upon termination (does not include retirement). Employees of the School have differing opinions; one employee felt that annual leave does not get paid unless due to retirement while another employee felt that annual leave gets paid upon any termination (regardless if due to retirement).

The Committee of Sponsoring Organizations of the Treadway Commission's report Internal Control - Integrated Framework (COSO) and the State of Delaware *Budget and Accounting Manual* state, "A well designed system of controls must include written policies and procedures to ensure that each control objective is met." Policies and procedures should be sufficient to allow for consistent interpretation and performance of functions.

The lack of specific language regarding annual pay upon termination, other than due to retirement, resulted in varying interpretations of the policy and questions regarding the need to record a compensated absences liability in the financial statements.

OTHER COMMENTS AND RECOMMENDATIONS

Recommendation

Positive Outcomes Charter School amend the policy entitled *Sick Leave and Absences and Other Reasons, Accumulation of Annual Leave* to include specific language regarding annual pay upon termination. The policy should be sufficient to allow for consistent interpretation.

Auditee Response

Positive Outcomes Charter School has amended the policy entitled *Sick Leave and Absences and Other Reasons, Accumulation of Annual Leave* it now includes specific language regarding annual pay upon termination. This amended policy was presented for first reading during the Board of Directors Meeting that was held on September 20, 2006. This policy should be approved on October 18, 2006.

Finding #3 – Accounts Payable

At the end of each fiscal year, the School compiles a listing of accounts payable to include in the current liabilities section of the financial statements. Amounts payable to PEAK and Because We Care for services rendered during fiscal year 2006, totaling \$7,468, were improperly excluded from accounts payable at June 30, 2006.

Generally Accepted Accounting Principles (GAAP) state, "Current liabilities are obligations whose liquidation is reasonably expected to require (a) the use of current assets or (b) the creation of other current liabilities." Current liabilities include payables due for goods and services received.

The School generally does not receive invoices from PEAK and Because We Care until October. The delay in billing contributed to the School overlooking the \$7,468 in accounts payable, with potential impact of understated liabilities in the financial statements.

Recommendation

Positive Outcomes Charter School develop a checklist for accounts payable. This checklist should include a listing of items usually included in accounts payable and should be used as guidance when preparing the annual listing of accounts payable.

Auditee Response

Positive Outcomes Charter School will develop a checklist for accounts payable prior to the end of the current fiscal year. This checklist will be utilized for our next engagement.

STATUS OF PRIOR YEAR OTHER COMMENTS AND RECOMMENDATIONS

Finding - Dollar Threshold for Capital Assets

The School's capital asset policy defines capital assets as assets with an initial individual cost of more than \$15,000 and an estimated useful life in excess of one year. The threshold is high in relation to the School's financial position. This could result in the misstatement of the School's financial statements.

GASB's Guide to Implementation of GASB 34 and Related Pronouncements states, "Authoritative pronouncements do not address the manner in which a capitalization policy should be established and applied. However, capitalization policies adopted by a government should find an appropriate balance between ensuring that all material capital assets, collectively, are capitalized and minimizing the costs of record keeping for capital assets. It may be appropriate for a government to establish a capitalization policy that would require capitalization of certain types of assets whose individual acquisition costs are less than the threshold for an individual asset. Computers, classroom furniture, and library books are assets that may be immaterial for capitalization on an individual basis, yet might be considered material collectively."

Recommendation

Positive Outcomes Charter School reduce its fixed asset threshold to a maximum of \$5,000 (in accordance with OMB's Circular A-122's requirements for assets purchased with federal funds), but preferably \$2,500.

The School should maintain an inventory listing of assets (furniture, computers, publicly appealing items, etc.) and take a physical inventory at a minimum once every two years. Management should review the inventory listing and determine if a threshold of \$2,500 (or a maximum of \$5,000) is sufficient or if the threshold should be lower.

Auditee Response

Positive Outcomes Charter School will lower our fixed assets threshold to \$5,000. We will review this ceiling after our next physical inventory to determine if this new threshold is sufficient. This policy will be drafted and approved by the Positive Outcomes Charter School Board of Directors by March 2006.

Current Year Status

Partially Implemented. The School reduced its fixed asset threshold to \$5,000 and is in the process of compiling a physical inventory listing.

Finding - Lack of Reconciliation of Payroll to DFMS

School officials were unable to provide evidence of reconciliation of payroll amounts to the general ledger (DFMS).

STATUS OF PRIOR YEAR OTHER COMMENTS AND RECOMMENDATIONS

According to the *State Budget and Accounting Manual*, Chapter II, "The following specific control objectives are widely accepted as elements of good control and should be used by management and financial managers:

Validation - ensuring that recorded transactions represent real transactions.
Authorization - ensuring that all transactions are approved by management."

Failure to perform payroll reconciliations may result in payroll record errors that are undetected.

Recommendation

Positive Outcomes Charter School's Business Manager should reconcile payroll amounts to the general ledger (DFMS). The School's Director should review the reconciliations and sign as evidence of his review and approval.

Auditee Response

Effective immediately the Positive Outcomes Charter School Business Manager will reconcile payroll amounts to the general ledger (DFMS). The school Director will review the reconciliations and sign as evidence of his review and approval.

Current Year Status

Implemented.

Finding - Lack of Written Policies and Procedures for School Store

Positive Outcomes Charter School operates a School Store (Store). The School does not have written policies and procedures related to monitoring, tracking, and reporting activity of the Store.

The *State Budget and Accounting Manual* states that, "Department or agency heads are responsible for establishing and maintaining an effective system of internal control." Additionally, the Manual states, "Internal control provides management with reasonable assurance that its policies and procedures are implemented and consistently followed to ensure efficient and effective organizational operation." Further, the Manual states, "A well designed system of controls must include written policies and procedures to ensure that each control objective is met."

Failure to adequately develop written procedures for financial processes can result in inadequate reporting of the School's financial transactions.

Recommendation

Positive Outcomes Charter School develop written policies and procedures for monitoring, tracking, and reporting activity of the School store. These policies and procedures should incorporate information such as (a) sufficient segregation of duties or mitigating controls, (b) specific job functions for each employee, including preparation and review, (c) frequency of deposits and reports, (d) purchasing and reimbursement, and (e) retainage of support documentation.

STATUS OF PRIOR YEAR OTHER COMMENTS AND RECOMMENDATIONS

Auditee Response

Positive Outcomes Charter School shall develop written policies and procedures for monitoring, tracking, and reporting activity of the School store. The policies will be drafted and approved by the Positive Outcomes Charter School Board of Directors by March 2006. These policies and procedures will incorporate information as listed: (a) sufficient segregation of duties or mitigating controls, (b) specific job functions for each employee, including preparation and review, (c) frequency of deposits and reports, (d) purchasing and reimbursement, and (e) retainage of support documentation.

Current Year Status

Implemented.